DENVER WATER

May 1, 2002

To the Board of Water Commissioners and Our Customers:

We are pleased to transmit the Comprehensive Annual Financial Report ("CAFR") of Denver Water for the year ended December 31, 2001.

Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with Denver Water. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of Denver Water. All disclosures necessary to enable the reader to gain an understanding of Denver Water's financial and operational activities have been included.

This report is presented in three sections as follows:

A. Introductory Section, which includes this transmittal letter, excerpts from the charter, organization chart, and list of principal officials.

B. Financial Section, which includes the financial statements, supplementary property and bond schedules, and the auditor's report on the financial statements and schedules.

C. Statistical Section, which includes selected operational and financial information, generally presented on a multi-year basis.

The Reporting Entity

The privately owned Denver City Water Company was organized in November 1870. It was merged into the Denver Union Water Company in October 1894, along with several smaller companies serving various parts of a growing Denver. In November 1918, the five-member governing board of the Denver Water Department purchased the company for the citizens of the City and County of Denver ("City"). The Denver Water Department was set up as an independent City water agency, with the philosophy that it would be operated as a business and remain separate from political influences.

Denver Water is governed by a five-member board appointed by the Mayor of the City for overlapping six-year terms. Denver Water has complete charge and control of a water works system and plant, which supplies water to customers located within the City and to entities serving other customers located in certain outlying areas in the Denver metropolitan area.

In accordance with Governmental Accounting Standards Board Statement No. 14, "The Financial Reporting Entity," Denver Water would be classified as 1) an "other stand-alone government" since Denver Water is a legally separate and distinct entity from the City under the Charter of the City, and the City is not financially accountable for Denver Water, and 2) a "related organization" since the Mayor of the City appoints Denver Water's governing body, but is not financially accountable. The City elects to include Denver Water's financial statements in its general-purpose financial statements as a component unit enterprise fund because, in the City's opinion, the nature and significance of Denver Water's relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete.

The Mission of Denver Water is as follows:

> *Denver Water will provide our customers with high quality water and excellent service through responsible and creative stewardship of the assets we manage. We will do this with a productive and diverse work force. We will actively participate in and be a responsible member of the water community.*

The Year 2001 In Review

Warmer weather, normal precipitation, and an increased customer base all combined to create a high demand for water in 2001. This demand was slightly less than that of 2000, though both years represent periods of high water utilization.

The average temperature in the Denver area last year was 51.3 degrees, about one degree above normal. The total precipitation for 2001 was 16.93 inches, which is 0.35 inches above average.

Denver Water served a population of approximately 1,081,000 people with treated water in 2001, a customer-base increase of 1.6% over the previous year. The warm weather in Denver, in conjunction with population growth, resulted in customers using 81.1 billion gallons of treated water, second only to the record treated-water use of 83.6 billion gallons in 2000. Although annual consumption was high, the peak day usage was only 489 million gallons on July 2; there were also 28 days on which consumption exceeded 400 million gallons. By comparison, the all-time peak day usage was 553 million gallons in 1989.

This past year was also the first since 1993 in which Denver Water’s raw water reservoirs did not completely fill. The reservoirs reached 98 percent of capacity on June 30, and finished the year at 81 percent of capacity, which is slightly less than normal. Additionally, 2001 was the first year Denver Water used water from its account in Wolford Mountain Reservoir. Because of the dryness in 2001, Denver Water was required to repay the Bureau of Reclamation for water diverted at Dillon Reservoir that was needed to fill Reclamation's Green Mountain Reservoir. Denver Water used Wolford water to repay a portion of its obligation to Reclamation.

Employment and Customer Statistics

Over the past 10 years, the number of Denver Water employees has decreased from 1,039 in 1991 to 1,026 at the end of 2001, a decrease of 13 (1 percent). Meanwhile, the average number of treated-water customer accounts rose from 254,937 in 1991 to 282,509 at the end of 2001, an 11 percent increase. There were 485 employees with 15 or more years of service. Twenty-one employees retired during the

year after contributing a combined total of 616 years to Denver Water. Denver Water continued to experience a comparatively low turnover rate of 7.1% including deaths and retirements in 2001.

Capital Construction

Capital projects consumed the largest share of Denver Water's budget, staff time, and focus in 2001. When complete, these projects will improve water quality and production efficiency, expand system capacity, and ensure the utility's ability to comply with federal, state, and local regulations. They include:

- Recycled Water Project. On May 14th, Denver Water broke ground on its Recycled Water Plant, the first phase of a two-phase construction effort. When this first phase is complete, the plant will produce 30 million gallons of recycled water a day for use by outdoor irrigation and industrial customers mainly in the northeast section of Denver. The projected cost of the first phase of this project is $71.4 million, of which Denver Water spent $14.6 million in 2001 and $18.1 million to date in 2002. The plant is scheduled to open in the spring of 2004.

- Marston Treatment Plant Upgrade. Denver Water is in the process of making significant upgrades and improvements at the Marston Treatment Plant to improve water quality and production efficiency and to increase treatment capacity. The total projected cost for this effort is $38.9 million, of which $10 million was spent in 2001. The upgrade project is scheduled for completion May of 2003.

- Foothills Treatment Plant Disinfection Clear Water Basin Construction. The two-year effort to construct disinfection improvements and a clear water basin at the Foothills Treatment Plant will help Denver Water comply with water quality regulations and provide additional water-storage capacity. This year saw several improvements to the plant, including the addition of a 25-million gallon storage reservoir. The projected cost for this project is $30.4 million, of which $15.5 million was spent in 2001. The work is scheduled to be completed in June of 2002.

- City Ditch-Related Construction. The City Ditch is a 19-mile, 140 year-old historic system that carries nonpotable, seasonally diverted water from the South Platte River to irrigation customers that include Washington Park and City Park. In February, the Colorado Department of Transportation informed Denver Water that an interstate-highway-improvement project would disrupt the supply of water in the ditch. Denver Water determined that the most efficient supply for its Ditch customers was the Recycled Water Plant. Rather than rebuild the ditch, Denver Water began building a temporary water supply line and a declorination station to serve Ditch customers with treated water until water from the Recycled Water Plant becomes available. The work will continue in 2002.

System Capacity Expansion

Denver Water did a number of things in 2001 to increase the current and future capacity of its water-delivery systems, including:

- Gravel Pit Purchase. Under a cooperative arrangement with the South Adams County Water and Sanitation District, Denver Water added approximately 360 acre feet of replacement capacity to its system with the acquisition of the Brinkman-Woodward Gravel Pit. Used in conjunction with the Recycled Water Plant and for replacement of upstream depletions, this gravel pit and others in the area will help Denver Water manage its water supply more efficiently.

- Fulton Ditch Agreement. In March, Denver Water reached an agreement for use of the Fulton Ditch, a critical component of the utility's northern gravel pit reservoir complex. Once improvements to the ditch have been constructed, the ditch will divert water from the South Platte River to the gravel pits in an amount not to exceed 200,000 acre feet over ten years.

- Gross Reservoir Relicensing/Improvements. In March, Denver Water received a license from the Federal Energy Regulatory Commission (FERC) to continue operating the Gross Reservoir. Located in Boulder County, the reservoir can store as much as 42,000 acre-feet of water and has the potential to generate up to five megawatts of electricity. Denver Water spent approximately $244,000 on relicensing costs and reservoir improvements in 2001 and plans to construct a hydropower facility at the reservoir beginning in 2003.

- Reservoir-Related Acquisitions. Denver Water acquired approximately 4,650 acres surrounding the Antero and Eleven Mile Canyon Reservoirs in Park County as well as flowage easements across approximately 270 acres at the Antero Reservoir. These acquisitions will enable Denver Water to own or have easements for all the properties critical for reservoir operations. Denver Water also added approximately 60 acres to its holdings around the proposed Leyden Reservoir in Jefferson County to obtain the property necessary for possible future reservoir construction.

Continuing Conservation

Conservation is key to Denver Water's ability to provide water to its customers. In 2001, these efforts included:

- Recognizing Conservation Efforts. Denver Water's commercial/industrial incentive program rewards companies and organizations for reducing their water use. In December, Denver Water recognized the efforts of the Denver Zoo, which is saving more than 3.5 million gallons of water annually as a result of changes made to their filtration and disinfection processes. Denver Water awarded the Zoo $20,000 for its efforts, the maximum allowed under the program. This payment works out to less than $2,000 per acre-foot for the saved water; the open-market price for water is far higher. Not only is the Zoo using water more efficiently and lowering its bills, it is freeing up relatively low-cost water that can be used to supply future Denver Water customers without requiring new water-supply projects.

- Denver Parks System Irrigation Survey. To ensure the most efficient delivery of water to Denver-area parks, Denver Water has joined with the Denver Parks Department to evaluate the Department's irrigation systems. The goal of this cooperative study is to create system-replacement and critical-maintenance priorities and a capital-equipment plan necessary to support them. The study is scheduled for completion in June of 2002.

- Xeriscape Program. A significant part of Denver Water's conservation effort involves encouraging customers to Xeriscape, a method of landscaping that reduces the need to irrigate. Xeriscape can save from 20% to 60% of the water normally applied to a traditional Kentucky bluegrass landscape. In 2001, Denver Water's Xeriscape outreach efforts included an online "Xeriscape of the Week" contest that featured pictures of a different Xeriscape on Denver Water's Web page each week during the irrigation season. Records show the site had almost 60,000 "hits" from May through August.

- Watershed Protection. In the wake of two successive fires near its reservoirs, Denver Water continued contracting with the Colorado State Forest Service to manage forests on more than 57,000 acres of the utility's land. Because half of this acreage is not directly used in the operation of the Denver Water system, professional management assistance, including fire management and forest management, are critical to preserve water quality. For these reasons, Denver Water renewed its contract with the Colorado Forest Service in 2001.

Financial Diligence

Denver Water customers have some of the lowest water bills in the Front Range region. Through the use of long-range financial planning, water-rate increases often approximate the rate of inflation. In addition to forward-looking capital construction and capacity planning—as well as conservation efforts—wise financial stewardship plays an important role in keeping customer rates low. Four events highlighted the importance of that role in 2001:

- Annual Rate Adjustments. Consistent with its long-term financial plan, Denver Water raised its rates by 2.5%.

- General Obligation Bond Refunding. In July, Denver Water refinanced approximately $86.4 million of general obligation bonds; the low interest rate on the new bonds will save more than $5 million over their lifetime.

- Certificates of Participation. In August, Denver Water issued Certificates of Participation (COPs), an alternative instrument for financing capital construction. The issue included the refinancing of $17.9 million of existing COPs, which will save $2.7 million over the lifetime of the debt. It also included $21.5 million of new COPs associated with the financing of water treatment projects at the Marston and Moffat plants.

- Debt Repurchase Authorization. In December, the Denver Water board authorized the repurchase of up to $10 million of existing debt, as changing market conditions can sometimes make it more affordable to retire debt rather than making debt payments against it. Denver Water remains vigilant for these kinds of buying opportunities in 2002.

Increasing Operational Efficiencies

From water meters that can report usage automatically to Internet-based bill paying and supply bidding, technology is playing a pivotal role in boosting operational efficiencies at Denver Water. In 2001, these efforts included:

- Automated Meter Reading Project. Denver Water completed the first year of a five-year, $40.2 million effort to install automated water meters that can report usage via radio signals. These meters include those in residential neighborhoods as well as outdated large-capacity meters that can underreport water consumption. When complete, the project will eliminate approximately 40 meter-reading positions and track water usage more precisely. To date, approximately 30,000 of 200,000 automated meters have been installed.

- New Treated Water-Distribution Model. In November, Denver Water began work on a new computerized model of its water-distribution system. Building upon previous models, this new

model will include all distribution pipes in the Denver Water system, enabling it to use the model for water quality, system improvements, fire flow, and other purposes.

- Total Service Improvement Class. Many water districts outside the Denver city limits have limited resources with which to perform system maintenance and monitor water quality. Denver Water's new Total Service Improvement class enables these areas to contract with Denver Water to assume these responsibilities. The costs for system improvements in these areas are spread over multi-year periods through the use of customized surcharges, which mitigate their impact on customers in the affected areas. In May, the Cherry Hills Farm Metropolitan District became the first Total Service Improvement class customer.

- E-Billing System. Denver Water continued its efforts to encourage customers to receive and pay their water bills online. For every customer who does so, the utility saves approximately $.24 compared to the cost of sending and processing a paper-based bill. To date, 862 customers receive and pay their bills electronically; more than 5,000 additional customers receive paper-based bills and pay them electronically.

- Remote Payment Stations. To further assist customers in paying their bills, Denver Water maintains several remote payment stations across the City of Denver. In 2001, approximately 51,000 bills were paid at these sites, resulting in approximately $8.3 million in revenue.

- E-Bidding Pilot Project. As part of a three-month pilot project, Denver Water evaluated the feasibility of awarding supplier contracts through online bidding. Such a system has the potential to increase the efficiencies of the utility's supply-bidding processes and allow for integration of its computerized bidding and financial systems.

- Map Accuracy Improvements. Denver Water contracted for more than $2.5 million to upgrade the accuracy of its maps in 2001. These investments included a major upgrade to the utility's Geographic Information System (GIS), which electronically captures maps once stored on paper; the use of Global Positioning Satellite (GPS) data to improve map accuracy; and software-related improvements that will enable it to share GIS-based information with engineering design, operations personnel, and with other government agencies.

Legal Issues

Denver Water resolved several key legal issues in 2001, including:

- Conduit 94 Litigation Settlement. In 1997, Denver Water's Conduit 94 ruptured, creating extensive flooding in Denver's "furniture row" area. Investigations revealed a manufacturer's defect in the conduit pipe, necessitating the replacement of 2,300 feet of Conduit 94. In 1998, Denver Water's Conduit 55, manufactured by the same company, also ruptured and had to be replaced in its entirety. Seven years earlier, in 1991, the pipe manufacturer declared Chapter 7 bankruptcy. After more than four years of litigation, Denver Water received a payment of just over $5 million from the bankruptcy proceedings. To date, Denver Water has spent more than $11 million on replacements and claims associated with the two pipe-break incidents.

- Building #3 Construction. As part of a legal settlement with the United States Environmental Protection Agency, Denver Water agreed to construct a building at its Westside Complex. The

building contains a carpentry shop, paint shop, hazardous materials handling area, and maintenance shop with facilities that utilize environmentally friendly technologies. In addition, it houses a new car wash that uses recycled water in its operation. Begun in October of 2000, Denver Water completed the building in December 2001 at a total cost of $3.96 million.

- Small/Disadvantaged Business Enterprises Program. In 2000, a court ruling effectively ended Denver Water contracting programs that aided minority and women-owned businesses. In September 2001, Denver Water adopted a new contracting program intended to enhance the economic growth and potential for small or disadvantaged business enterprises and to assist such enterprises in competing for Denver Water construction, purchasing, and professional services contracts.

Public Safety Planning

The events of September 11 brought a sharp focus on security issues, especially those related to critical public infrastructures. Since then, Denver Water has worked and will continue to work with all appropriate agencies and decision makers to ensure the security of its water collection, storage, treatment, and delivery systems.

Financial Information

Discussion of Controls

Internal Control Structure. Management of Denver Water is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of Denver Water are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Controls. In addition, although Denver Water is not legally required to adopt budgetary accounting and reporting and make appropriations for expenditures, it does maintain budgetary controls through a formal budget process, which involves:

- Maintaining a long-range plan for addition and replacement of water system facilities based on projected demands for water, which is updated annually and is used as a basis for projecting capital expenditures in the budget.

- Maintaining a long-range plan for operation and maintenance activities.

- Developing a long-range financial plan for issuance of debt and adjustment of water rates.

- Developing annual work plans by program (raw water, reuse, water treatment, delivery, and general plant), based on the long-range plan, for operation and maintenance activities and capital projects.

- Establishing cost control center budgets for labor, materials, and services for each of the projects or activities listed on the annual operation and maintenance and capital work plans, which are combined on a total entity basis.

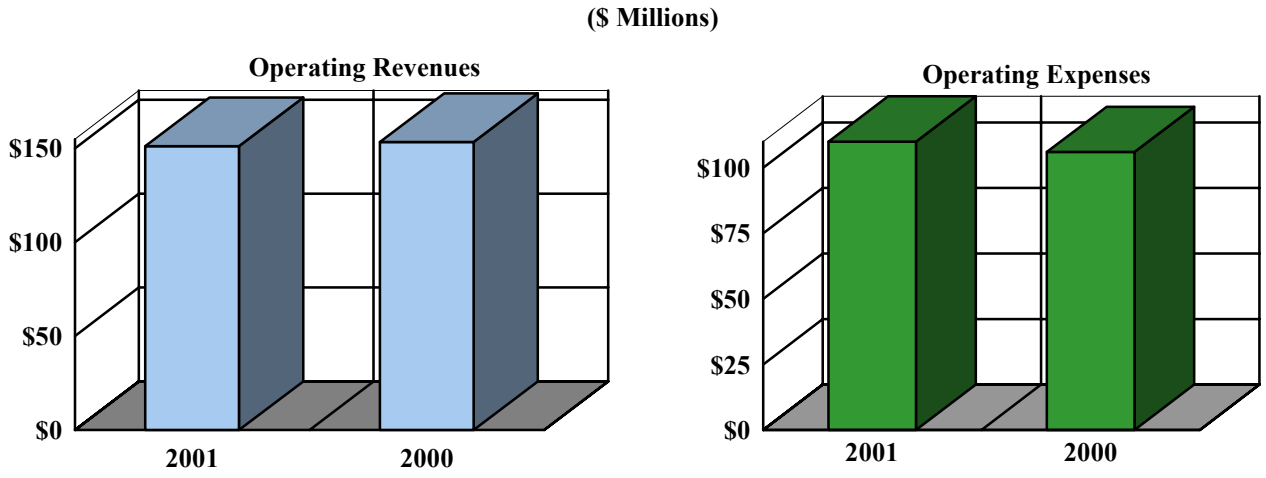
- Providing explanations for significant variances between budgeted and actual expenditures to the Board on a quarterly basis.

Discussion of 2001 Operating Results

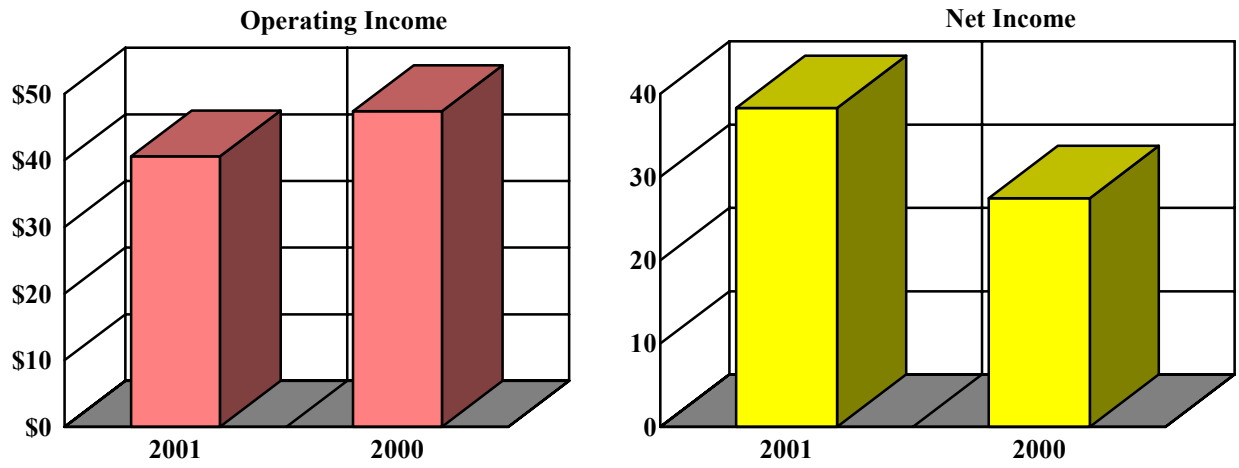
Summary operating results compared to last year are as follows (amounts expressed in thousands):

	2001	2000	Increase (Decrease)	Percent Change
Operating revenues	$ 151,198	$ 153,429	$ (2,231)	(1)%
Operating expenses	(110,618)	(106,066)	4,552	4%
Operating income	40,580	47,363	(6,783)	(14)%
Net nonoperating expenses	(2,323)	(19,927)	(17,604)	(88)%
Net income	$ 38,257	$ 27,436	$ 10,821	39%

(See Financial Section for more details and Statistical Section for ten-year trend data.)



($ Millions)



Operating revenues decreased primarily as a result of a 3% decrease in treated water consumption, offset by a rate increase effective January 1, 2001. ***Operating expenses*** increased as a result of general increases in labor, supply, service and maintenance costs. ***Net Nonoperating Expenses*** decreased primarily as a result of a $14.6 million write-off of obsolete engineering development costs in 2000 and receipt of a $5.1 million lawsuit settlement in 2001 for Conduit 94 and 55 breaks.

Additions to Property, Plant and Equipment

Capital additions for 2001 amounted to $104.7 million, which is $17.2 million or 20% more than the additions in 2000. Additions included $78.7 million for new facilities, $20.1 million for facility replacements and improvements, and $5.9 million for general equipment. See "Additions to Property, Plant and Equipment" in the Statistical Section for more details.

Pension Trust Fund Operations

Net assets available for plan benefits decreased $20,720,100 in 2001, after contributions, benefit payments and gains and losses on investments, to a total of $180.3 million as of December 31, 2001. There was an excess of assets over the actuarial liability at January 1, 2001 of $6.7 million or 14.3% of covered payroll. This compares to an excess of assets over liabilities of $6.0 million or 13.2% of covered payroll at January 1, 2000. The pension trust fund investment return was –5.96% for 2001. This return compares with a return of –11.89% for the Standard & Poor's 500 and 8.5% for the Lehman Government/Credit index. The annual actuarial valuation continues to reflect a well-funded plan. See Note 8 in the Financial Section for more details.

Debt Administration

During the year, Denver Water issued $86,385,000 of City and County of Denver general obligation ("GO") water refunding bonds in two series. Series 2001A in the amount of $11,215,000 was used to pay principal of bonds which matured during the year. Series 2001B in the amount of $75,170,000 was used to currently refund $49,045,000 and advance refund $28,945,000 of bonds that will mature from 2002 through 2009. At December 31, 2001, bonds totaling $208,140,000 were outstanding. Since Denver Water is committed to repay the bonds and related interest from its revenues, they are not included in any City debt limitations. At the time of sale, Denver Water received an AA+ rating from Standard & Poor's Rating Group, an AA+ rating from Fitch Ratings and an Aa1 rating from Moody's Investors Service, Inc. for the 2001 Series GO water refunding bonds issued in September. At year-end,

Denver Water had obligations totaling $67,885,000 under Certificates of Participation, and $31,429,000 Obligation Under Capital Leases. See Notes 4, 5, and 6 in the Financial Section for more details.

Disclosure Requirements

Certain information is being provided by Denver Water pursuant to various Continuing Disclosure Undertakings that have been executed by the Board in order that participating underwriters may comply with Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission. The Government Finance Officers Association of the United States and Canada ("GFOA") recommends that these disclosures be contained in the CAFR. These disclosures made by Denver Water can be found on the following pages:

Audited Financial Statements	Section B - Financial Section
Total Outstanding Indebtedness	Section B - Notes 4, 5, 6, Exhibits II-A through D
Total Treated Water Delivery/Consumption	Page C-25
Number of Customer Accounts	Page C-49
Receipts and Expenditures	Page C-56, C-57
System Development Charges and Participation Fees	Page C-58

Cash Management

The principal objective of Denver Water's investment policy is safety while attaining an appropriate rate of return. At year-end, approximately 62% of the investments were held in US government and agency securities. The remaining investments were in commercial paper, rated A-1 or P-1 by Standard & Poor's or Moody's, investment grade corporate bonds and in money market mutual funds. All securities were classified as category one, the category of least custodial credit risk as defined by the Governmental Accounting Standards Board. Denver Water earned interest income of $8.0 million on the cash management portfolio investments for the year. The 12-month total return on the portfolio was 4.752%. See Note 3 in the Financial Section for more details.

Risk Management

The Board has a risk management program that includes self-insurance for liability, and self-insurance for employee medical and dental benefits through a commercial claims servicer. The Board carries commercial property insurance for catastrophic losses, including floods and earthquakes, for five major facilities, and carries limited insurance for other miscellaneous locations. The Board also carries commercial insurance for employee life, accident, and workers' compensation. Denver Water's liability is limited under the Colorado Governmental Immunity Act to $150,000 per person and $600,000 per occurrence. Denver Water has designated $7.5 million of its investments as available for claims covered by self-insurance. See Note 10 in the Financial Section for more details.

Other Information

Independent Audit

The City Charter requires an annual audit of the accounts of Denver Water by the City Auditor. The independent accounting firm of Arthur Andersen LLP was jointly selected by the City Auditor and Denver Water to conduct this audit for 2001. Arthur Andersen's report is included in the financial section of this report.

Awards

Comprehensive Annual Financial Report. The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to Denver Water for its CAFR for the fiscal year ended December 31, 2000. This was the thirteenth consecutive year that Denver Water has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

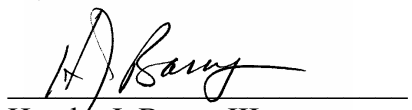
A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Annual Budget. The GFOA presented an award for Distinguished Budget Presentation to Denver Water for its annual budget for the fiscal year beginning January 1, 2001. This is the ninth consecutive year Denver Water has received this award. In order to receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan, and as a communications device. The award is valid for a period of one year only. We believe our current budget continues to conform to program requirements, and we are submitting it to the GFOA to determine its eligibility for another award.

Acknowledgments

This report was prepared by the staff of Denver Water with the leadership and support of the Board of Water Commissioners.

Sincerely,



Hamlet J. Barry, III
Manager, Denver Water

David B. LaFrance
Director of Finance